July 16, 2002

Oil and Gas Docket No. 06-0229019

COMMISSION CALLED HEARING ON THE COMPLAINT OF THE LONG TRUSTS REGARDING WHETHER PROPER NOTICE WAS GIVEN BY UNION PACIFIC RESOURCES CO. OF ITS APPLICATION FOR AN EXCEPTION TO STATEWIDE RULE 37, BARKSDALE ESTATE GAS UNIT, WELL NO. 8, OAK HILL (COTTON VALLEY) FIELD, RUSK COUNTY, TEXAS.

APPEARANCES:

For RME Petroleum Company:

Brian Sullivan
Carol Alexander
Lynn Ray
Mary Patton
William Cobb
Larry Dixon
Rick McCrary
John Ely
David Davies

For The Long Trusts:

John Hays
Gregg Owens
Harlan Abright
Kerry Pollard
Larry Long

PROPOSAL FOR DECISION

PROCEDURAL HISTORY

COMPLAINT FILED:	May 23, 2001
NOTICE OF HEARING:	August 31, 2001
HEARING DATES:	December 12-14, 2001
HEARD BY:	Mark Helmueller - Hearings Examiner Donna Chandler - Technical Examiner
RECORD CLOSED:	January 29, 2002
PROPOSAL FOR DECISION ISSUED:	July 16, 2002

Statement of the Case

This case arises from the complaint of the Long Trusts ("Long") that it did not receive proper notice from Union Pacific Resources Co. ("UPRC") of its Application for an Exception to Statewide Rule 37, Barksdale Estate Gas Unit, Well No. 8, Oak Hill (Cotton Valley) Field, Rusk County, Texas. The Barksdale Estate Gas Unit is an irregularly shaped 604.341 acre pooled unit which is currently operated by RME Petroleum Company ("RME"). The well is located in a panhandle section of the unit 355 feet from both the nearest eastern and western lease lines. The well is regular to all other lease line boundaries. A copy of the plat filed with UPRC's W-1 Application for Permit to Drill, Deepen, Plug Back or Re-Enter is attached. The Oak Hill (Cotton Valley) field rules specify spacing requirements of 660 feet minimum spacing to the nearest lease line and 1000 feet minimum spacing between wells. Prior to the hearing, the examiners determined that a single hearing would be appropriate for consideration of both Long's complaint and RME's claim that it is entitled to an exception to Statewide Rule 37 for the Barksdale Estate Gas Unit, Well No. 8.

The Barksdale Estate Gas Unit, Well No. 8, was completed in May 1998 in the Oak Hill (Cotton Valley) Field. The well has produced continuously from the field since that time. At the time of the hearing the well had produced a cumulative total of 530 mmcf.

At the commencement of the hearing, the parties agreed that the primary burden of proof in the case was on RME. It was not disputed that Long did not receive notice of the application for an exception to Statewide Rule 37 in the manner required by Commission rules before the application was administratively approved. Long is the operator of the Marwil Unit which offsets the panhandle section of the Barksdale Unit on the west.

RME's Position and Evidence

RME contends that its Barksdale No. 8 was permitted in good faith, but that a clerical error by a third party resulted in the preparation of an inaccurate plat which was used for the last four wells permitted and approved for the Barksdale Estate Gas Unit.[1] The inaccurate plat failed to identify Long as the offset operator to the west of the panhandle portion of the unit where the Barksdale No. 8 was drilled. Because Long was not identified as the offset operator, they were not provided notice of the application for an exception to Rule 37. The application was approved administratively based on a waiver submitted for Sonat Exploration, which appears on the plat as the offset operator to west of the panhandle tract.

RME also contends that Long had actual notice of the well's location before the well was drilled because it was a 25% working interest owner in the well. Due to this ownership interest, Long was provided with an approval for expenditure ("AFE") and well location plats for all of the Barksdale wells, including the Barksdale No. 8. RME argues that the plat for the Barksdale No. 8 clearly depicts the well at a Rule 37 location even though it does not identify Long as the offset

[1] Well Nos. 5, 6, and 7 did not require lease line spacing exceptions.

operator of the Marwil Unit. RME notes that Long signed the AFE for the well in March 1998 before the well was drilled. RME also argues that the following facts repudiate Long's claim that it was unaware of the well location until it filed its complaint with the Commission: 1) Long was an experienced and sophisticated operator who had participated as a working interest owner in the Barksdale Estate Gas Unit from its inception in March 1983; 2) Long operated the adjacent Marwil Unit; 3) Long was aware of the applicable field rules for the area; 4) Long was aware of the borders of their Marwil Unit; 5) Long required disclosure of detailed geology concerning the development of wells in the area; and 6) Long elected to participate in the well.

RME alternatively argues that the permit for the Barksdale No. 8 is not void, but voidable. RME contends that the Commission had proper jurisdiction to grant the exception permit and properly processed the permit for administrative approval. RME therefore claims that the permit is not a nullity because it was properly processed.

RME believes that the linchpin of this argument is that the permit was granted erroneously making the permit voidable. If one treats the permit as voidable instead of void, Texas law requires that the permit be attacked directly within the proper time period. Because Long failed to complain to the Commission for at least 18 months while it participated in the well as an interest owner, RME argues that the voidable permit has become permanently valid by Long's inaction. RME cites *Midas v. Stanolind Oil & Gas Co.,* 179 S.W.2d 417 (Tex. 1944) as support for this argument.

RME also argues that it is entitled to an exception to the minimum lease line distance requirements in order to protect its correlative rights and to prevent waste. With respect to the protection of its correlative rights, RME contends that drilling and producing the Barksdale No. 8 allows it to recover 133 mmcf of natural gas which would not be recovered by existing wells or other wells at regular locations on the unit. RME submits that the No. 8 well is therefore necessary to prevent confiscation.

With respect to the prevention of waste, RME claims there are four unusual conditions in this area of the Oak Hill (Cotton Valley) Field each of which alone would justify an exception location. First, the panhandle shape and size of the area where the well was drilled is only 710 feet wide and therefore no regular locations are available within the panhandle of the unit. RME contends that wells drilled at regular 660 foot locations would not allow for adequate drainage of the panhandle in this tight reservoir.

The second unusual condition is geological. RME's geologist testified that the unit is part of a western depocenter during the deposition of the Taylor interval. Interval thickness maps show a more rapid deposition across the general location of the Barksdale No. 8. This interval will have greater heterogeneity and more vertical changes in lithology and grain size in the area of the well. This in turn affects both the permeability and porosity in the vicinity of this well. RME contends that the decreased permeability and porosity in this area would prevent proper drainage of the panhandle from wells at regular locations.

The third unusual condition is the existing wellbore doctrine. RME argues that it drilled the well in good faith and not as a subterfuge to obtain a Rule 37 exception. RME claims it retained a professional title services company to identify any offset operators and reasonably relied on its work product. RME claims that no one was aware of the error in failing to identify Long as the offset operator. Accordingly, RME believes that this case is similar to the holding of the Texas Supreme Court in *Exxon v. Railroad Commission of Texas*, 571 S.W. 2d 497 (Texas 1978), in that it drilled the well in good faith and not as an attempt to bolster a future exception to Commission rules.

The fourth unusual condition is that the well will cause no more harm than a well at a regular location based on reservoir simulation studies comparing the current well to a proposed well at a regular location. RME contends that the simulation shows virtually no difference in the drainage of the Marwil Unit when comparing the two alternate locations.

Finally, RME contends based on its reservoir simulation study that depending on well development surrounding the panhandle section, the Barksdale No. 8 will recover a range between 224 and 1,056 mmcf of gas that would not be otherwise recoverable.

Long's Position and Evidence

Long argues that the Barksdale No. 8 is an illegal well because the permit was obtained without providing proper notice to the affected offset operators. Long further contends that the defective notice renders the permit void, not voidable. Finally, Long claims that proper enforcement of Commission rules requires that the well be permanently shut-in, plugged and abandoned.

Long claims that RME's admission that notice was not provided as required by Commission rules prior to obtaining the permit is dispositive. Long rejects RME's arguments that somehow Long received actual notice or waived any protest as contrary to the provisions of Rule 37(h)(2)(B). Long argues that the rule specifically requires notice to be given prior to the issuance of the permit. Actual notice through participation in the well is not a recognized substitute for proper notice as required under the rule.

Long further contends that the only permissible waiver under Rule 37 is by a written waiver of objection. Long argues that the doctrines of waiver, estoppel and laches cannot be properly applied in this case, noting that these equitable powers are not vested in the Commission or found in Rule 37. Additionally, Long claims that it never waived its right to object to the location.

Long further claims that the equitable doctrine of estoppel does not apply because the party invoking the doctrine must show that it relied on a false representation or concealment of material facts. Long argues that RME cannot meet this burden. Long also contends that the equitable defense of laches does not apply because the doctrine cannot be predicated on a void order.

Long also argues that RME failed to establish that a Rule 37 exception is necessary to prevent waste or confiscation. With respect to an exception to prevent waste, Long contends that RME did not show that wells at regular locations would not recover the remaining hydrocarbons, noting specifically that RME failed to rule out that a well at a regular location on RME's Alford Unit, which offsets the Barksdale Estate Gas Unit to the east would recover any remaining reserves. Long also contends that the remaining gas underlying the panhandle tract is not substantial.

Long asserts that RME also failed to show that an exception is necessary to prevent confiscation. Long claims that several regular locations exist on the Barksdale Estate Gas Unit which provide the opportunity to recover its fair share of hydrocarbons underlying the unit.

EXAMINERS' OPINION

The Permit to Drill the Barksdale No. 8 is Voidable, not Void

Before addressing any evidence on RME's claim that an exception to Rule 37 is appropriate for the Barksdale No. 8, it is necessary to analyze the legal sufficiency of the Commission's issuance of the original permit. The two parties take different views of this issue. Long argues that the permit is void due to the admitted defect in notice. RME contends that the permit is not void, but is voidable on the proper complaint of an aggrieved party that was injured by the Commission's action. Further complicating this analysis is the fact that Long is a 25% interest owner in the Barksdale No. 8. Long admitted that it participated in the well for at least 18 months before it first raised any question concerning the permit's validity.

The examiners reject Long's argument that permit issued for the Barksdale No. 8 is void due to the lack of notice provided to Long. In this case, as discussed in greater detail below, Long clearly was provided with actual notice of the proposed location, including a plat which identified the distance from the nearest lease line, before the well was drilled. Additionally, it is clear that UPRC attempted to permit the well pursuant to the appropriate administrative procedures adopted by the Commission for approval of lease line exception applications. UPRC did not hide the fact that the well was at an irregular location. UPRC also properly represented that, while it was its own offset on one side of the panhandle, another operator was the offset to the west. UPRC or its agent did err in identifying that operator, but it otherwise proceeded to permit the well appropriately by obtaining a waiver from that operator of any protest to the requested lease line spacing exception. Under these circumstances, it would appear that the Commission acted appropriately and within its statutory authority in granting the permit administratively. These facts indicate that the permit was not void but instead was voidable.

Laches and Actual Knowledge of Well Location Provided to Long

The examiners also believe that the equitable doctrine of laches provides appropriate guidance in how the Commission should address Long's participation in the well. Long claims that it did not receive proper notice making the permit invalid and all production illegal.

To prove laches, it must be shown that there was an unreasonable delay in asserting a legal or equitable right and a good faith change of position by another to his detriment because of the delay. *Rogers v. Ricane Enterprises, Inc.*, 772 S.W.2d 76, 80 (Tex.1989); *City of Fort Worth v. Johnson*, 388 S.W.2d 400, 403 (Tex.1964); *Campbell v. Pirtle*, 790 S.W.2d 372, 375 (Tex.App.--Amarillo 1990, no writ). If the delay impairs the defendant's ability to defend against the claim or ascertain the true facts, then the claim should be barred for laches. *De Benavides v. Warren*,
674 S.W.2d 353, 362 (Tex.App.--San Antonio 1984, writ ref'd n.r.e.); see also *Altech Controls Corp. v. E.I.L. Instruments, Inc.*, 33 F.Supp.2d 546, 553 (S.D.Tex.1998).

The question of long delay in attacking the orders of the Commission was considered in *Midas Oil Co. v. Stanolind Oil & Gas Co.*, 142 Tex. 417, 179 S.W.2d 43,

> [W]e are satisfied that it was the intention of the Legislature that such a suit should be filed within a reasonable time after the granting of the permit, and if an interested party fails to bring such suit within a reasonable time, and in the meantime the permittee begins the drilling of the well or otherwise incurs substantial obligations in the prosecution of his rights thereunder, the contestant should be held to have lost his right to prosecute such a suit.

While the cases concerning laches and the delay in attacking Commission orders have not been directly applied by the Commission in cases concerning notice, the case law is persuasive authority as to how the Commission should deal with the unique facts presented in this case. The examiners believe that where a party possesses actual detailed knowledge of a well's location before the well is drilled and is directly benefitting in the production from a well, that party cannot "lay behind the log" by delaying a challenge to a permit that was administratively granted by the Commission under proper procedures but based on erroneous information. The dangers of allowing such a late attack on a permit which was processed properly are illustrated in this case not only by the substantial obligations and costs associated with drilling, completing and operating the well, but by the change in operator from UPRC to RME.

The evidence shows that Long was aware of the location of the Barksdale No. 8 well in March 1988 before the well was drilled. Long elected to participate in the well as a 25% working interest owner. It has reaped the benefits of that participation from the time that the well was put in production to the time it filed its complaint. The examiners believe that Long's failure to raise this issue earlier could be excused if it had not been privy to the knowledge of the well's exception location. But Long cannot now, at this late date, divorce itself from that knowledge and its participation in the well as a working interest owner. Finally, as noted below, the examiners believe that UPRC would have been entitled to a Rule 37 exception even if Long had timely raised a protest. Accordingly, the examiners' reject Long's argument that the original permit is invalid and that all production from the Barksdale No. 8 is illegal.

An Exception to Rule 37 for the Barksdale No. 8 is Necessary to Prevent Waste

An applicant seeking an exception based on waste must establish three elements:1) that unusual conditions, different from conditions in adjacent parts of the field, exist under the tract for which the exception is sought; 2) that, as a result of these conditions, hydrocarbons will be recovered by the well for which a permit is sought that would not be recovered by any existing well or by additional wells drilled at regular locations; and, 3) that the volume of otherwise unrecoverable hydrocarbons is substantial.

The Commission has previously determined that lease geometry in conjunction with reservoir characteristics may constitute an unusual condition in support of a lease line exception to prevent waste. *Rule 37 Case No. 0200641*, *Application of Marathon Oil Company for an Exception to Statewide Rule 37 to Drill its No. 1 Well, Babb-Drawe Lease, Giddings (Austin Chalk -3) and Giddings (Austin Chalk - Gas) Fields, Fayette County, Texas* (Final Order entered May 11, 1993).

No locations regular to lease line spacing requirements exist on the panhandle section of the Barksdale Unit. The parties also agree that this reservoir has been designated as a tight gas sand. Additionally, RME's undisputed geologic evidence depicts reservoir characteristics which constitute an unusual condition in support of a lease line exception to prevent waste. There was a rapid depositional environment in this area in contrast to the field as a whole. This subsurface geology impacts the heterogeneity, permeability and porosity in the area of the Barksdale No. 8. In other words, the lease geometry in conjunction with reservoir characteristics created by the subsurface geology in the area of the well constitutes an unusual condition which precludes the panhandle section of the unit from being properly drained by wells at regular locations.

Finally, RME established through its reservoir simulation study that the Barksdale No. 8 will recover a substantial volume of hydrocarbons that otherwise would not have been recovered by a well at a regular location. The additional natural gas that would be recovered by the well is between 224 mmcf and 1056 mmcf, depending on future well development in the area. This satisfies the final element of RME's waste case as these volumes are considered substantial.

It is the examiners' conclusion that the permit originally issued was not void, but rather was voidable upon a timely complaint. Long did not file a timely complaint. It had actual knowledge of the well's location in March 1998 and participated in the well as an interest owner. Additionally, the evidence supports granting RME's application for an exception to Rule 37 to prevent waste. [2] The examiners therefore recommend that the permit administratively granted for the Barksdale No. 8 be affirmed. The examiners further recommend that the complaint be dismissed.

Based on the record in this Docket, the examiners recommend adoption of the following Findings of Fact and Conclusions of Law.

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[2]Because RME's an exception to lease line spacing requirements is appropriate to prevent waste, it is not necessary to consider RME's other arguments concerning economic waste and confiscation.

FINDINGS OF FACT

1. RME Petroleum Company ("RME") seeks an exception to Statewide Rule 37 for its Barksdale Estate Gas Unit, Well No. 8, ("Barksdale No. 8") Oak Hill (Cotton Valley) Field, Rusk County, Texas.

2. The Barksdale Estate Gas Unit is an irregularly shaped 604.341 acre pooled unit which is currently operated by RME. The well is located in a panhandle section of the unit 355 feet from both the nearest eastern and western lease lines. The well is regular to all other lease line boundaries. A copy of the plat filed with Applicant's W-1 Application for Permit to Drill, Deepen, Plug Back or Re-Enter is attached.

3. The Oak Hill (Cotton Valley) Field rules specify spacing requirements of 660 feet minimum spacing to the nearest lease line and 1000 feet minimum spacing between wells.

4. The Long Trusts ("Long") did not receive notice of the original Application for an Exception to Statewide Rule 37 in the manner required by Commission rules for the Barksdale No. 8, from the operator that drilled the well, Union Pacific Resources Co. ("UPRC"). The plat attached to Commission Form W-1 does not properly identify Long as an offset operator entitled to notice of the application.

5. UPRC's permit to drill the Barksdale No. 8 was administratively approved based on the erroneous designation of the offset operator to the west of the panhandle section.

6. Long had actual knowledge of the location of the Barksdale No. 8 before the well was drilled because it was a 25% working interest owner in the well.

    a. Due to its working interest, Long was provided with an approval for expenditure ("AFE") and well location plats for the Barksdale No. 8.

    b. The well location plat provided to Long clearly depicts the well at a Rule 37 location even though it does not identify Long as the offset operator of the Marwil Unit.

    c. Long signed the AFE for the well in March 1998 before the well was drilled.

7. The Barksdale No. 8, was completed in May 1998 in the Oak Hill (Cotton Valley) Field. The well has produced continuously from the field since that time. At the time of the hearing the well had produced cumulative total of 530 mmcf.

8. Long did not file a complaint contesting the validity of permit until May 23, 2001.

9. Locations regular to all lease lines exist on the Barksdale Estate Gas Unit. No regular location exists in the panhandle section of the Barksdale Estate Gas Unit.

10. The undisputed geologic evidence shows that there was a rapid depositional environment in the area of the Barksdale No. 8 as contrasted to the field as a whole.

11. The impact of the depositional environment on the heterogeneity, permeability and porosity in the area of the Barksdale No. 8 and the lease geometry of the panhandle tract constitutes an unusual condition which would preclude the panhandle section of the unit from being adequately drained by wells at regular locations.

12. The Barksdale No. 8 will recover a range between 224 and 1,056 mmcf of gas that would not be otherwise recoverable by wells at regular locations.

CONCLUSIONS OF LAW

1. Proper notice of hearing was timely given to all persons legally entitled to notice.

2. All things have occurred to give the Commission jurisdiction to decide this matter.

3. The permit granted to UPRC to drill Well No. 8 on the Barksdale Estate Gas Unit was not void, but was voidable upon a timely complaint to the Commission.

4. Long had actual knowledge of the location of the Barksdale No. 8 in March 1988.

5. Long did not file a timely complaint with the Commission challenging the validity of the permit for the Barksdale No. 8.

6. An exception to Statewide Rule 37 for a well at the applied-for location is necessary to prevent waste from the Oak Hill (Cotton Valley) Field.

RECOMMENDATION

The examiners recommend that the permit administratively granted to Union Pacific Resources Company for the Barksdale Estate Gas Unit Well No. 8 be affirmed as proper. The current operator, RME Petroleum Company's has established that an exception to the lease line spacing requirements of Rule 37 is necessary to prevent waste. Additionally, the complainant, the Long Trusts, failed to establish that it acted expeditiously in seeking to challenge the permit. The examiners' therefore further recommend that the complaint of the Long Trusts be dismissed.

Respectfully submitted,

Mark J. Helmueller
Hearings Examiner

Donna Chandler
Technical Examiner